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In the Matter of )  
 )  
1997 ANNUAL ACCESS TARIFF FILINGS ) CC Docket No. 97-149  
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**AT&T OPPOSITION TO DIRECT CASES**

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## SUMMARY

As AT&T showed in its June 23, 1997 petition addressed to the annual filings of price cap local exchange carrier ("LECs"), with the passage of the Telecommunications Act of 1996, the need to eliminate excessive and unjustified interstate access rate levels has become critical. LECs have typically enjoyed access revenues that dwarf the costs of providing access -- and that, consequently, generate billions of dollars annually in additional profits to those monopolies.

The passage of the 1996 Act means that these surplus profits no longer merely distort long distance competition by artificially inflating interexchange carriers' costs of doing business. The core goal of the Act is to create local exchange competition, and thus mandates that all implicit subsidies be removed from interstate access charges, and that prices be driven to true economic costs.

Although in its May 16, 1997 Access Reform Order the Commission elected to order only modest reductions in interstate access rates on the assumption that developing competitive forces in the access and exchange markets would drive access rates to competitive levels, the filings of the price cap LECs did not generate even the expected \$1.7 billion interstate access reduction. The total price

cap LEC access reduction in the recent annual tariff filings is only about \$1.5 billion -- contrary to AT&T's estimates and expectations.

Based on additional data supplied in the Direct Cases, AT&T's current analysis of the price cap LECs' 1997 annual interstate access tariff filings indicates that the LECs' tariffs, through misprojections and other failures to comply with Commission directives, appear to overstate their price cap indices, in the aggregate, by approximately \$465 million. Prompt and decisive Commission action on this investigation will ensure that the LECs do not hang onto these improper access revenues.

Part I shows that a number of LECs have erroneously projected their common line base factor portion revenue requirements. According to AT&T's year-over-year (1991-1996) trend analysis based on the Direct Cases, the LECs have understated their end user common line revenues by \$400 million and, consequently, have overstated their common line rate caps by \$400 million. In their Direct Cases, the LECs have not justified their BFP revenue requirement forecast for the 1997-1998 tariff period even though, in most cases, they deviate significantly from historical results.

Part II shows that most LECs have failed to make the proper exogenous cost adjustment to remove fully equal

access amortization expenses from their price cap indices, as they were directed to do by the Access Reform Order. Although the LECs challenge the need for, and the legality of, an "R" value true-up of their equal access exogenous adjustment, their contentions are meritless. Basing the "R" value true-up on the change in Local Switching band revenues since the inception of price caps, as the Bureau ordered here, is appropriate not only because the revenue composition of the Traffic Sensitive basket changed markedly with the local transport restructure, but also because equal access costs at all times have been recovered through the Local Switching band, whether through local switching rates or a distinct equal access cost recovery rate element.

Most LECs instead made an improper PCI deflation adjustment to their equal access amortization exogenous costs and then failed to account for revenue growth. As a result, in aggregate, the LECs have failed to remove an additional \$60.7 million in equal access costs from their PCIs. Additionally, Ameritech has understated the equal access amortization costs that were included in its initial PCIs by \$1 million.

Part III shows that Pacific and U S WEST have failed to justify their treatment of Other Billing and Collection ("OB&C") expenses. Pacific improperly excluded invoice-ready messages from the message counts used to

allocate the message portion of OB&C expenses to interstate, thereby improperly increasing its OB&C exogenous cost by approximately \$4.5 million. U S WEST, on the other hand, improperly included retroactive OB&C costs of \$845,145 in its annual filing.

As shown in Part IV, several rate-of-return carriers have failed to justify their treatment of cash working capital, despite the fact that they were required to do so, having elected to use net lag periods more than three times as long as the Commission's standard 15-day lag period. As a result, these companies should be required to recalculate their interstate revenue requirements using justifiable data to calculate lead-lag studies.

In the Matter of )  
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1997 ANNUAL ACCESS TARIFF FILINGS ) CC Docket No. 97-149  
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Pursuant to the July 28, 1997 Designation Order, AT&T hereby opposes the Direct Cases filed by price cap and rate-of-return local exchange carriers ("LECs") concerning the lawfulness of various issues raised by their 1997 interstate annual access tariff filings.<sup>1</sup> In the 1997 Suspension Order, the Commission suspended these tariffs for one day and allowed them to take effect subject to the outcome of this investigation and an accounting order.<sup>2</sup> At

2     1997 Annual Access Tariff Filings, CC Docket No. 97-149, Memorandum Opinion and Order, DA 97-1350, released June 27, 1997 ("1997 Suspension Order"). The Commission suspended one LEC's tariff by a separate order, DA 97-1413, released July 7, 1997 ("Roseville Suspension Order"). On June 23, 1997, AT&T had filed separate Petitions addressed to the 1997 annual access tariff filings of the price cap and rate-of-return

issue in the investigation, for price cap companies, are the common line costs of 15 carriers, equal access exogenous cost adjustments for 13 carriers, and other billing and collection ("OB&C") expenses for four carriers.<sup>3</sup> Also at issue is the cash working capital ("CWC") of four rate-of-return companies. Id.

For the reasons discussed below, the Direct Cases of these LECs fail to justify their treatment of these costs and therefore their access tariffs are unreasonable.<sup>4</sup> Accordingly, the Commission should require these companies to revise their rates prospectively, to refund the overstated amounts collected during the pendency of this investigation, and, in the case of the price cap companies, to reduce their price cap indices ("PCIs").

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LECs, respectively, and, on June 27, 1997, a Petition addressed to Roseville's annual filing.

<sup>3</sup> Designation Order, para. 2.

<sup>4</sup> In this investigation, the LECs bear the burden of proving that their tariffs are just and reasonable. Designation Order, para. 13; Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996, CC Docket No. 96-187, Report and Order, FCC 97-23, released January 31, 1997, para. 19 ("LEC Streamlining Order").

I. A NUMBER OF LECS HAVE FAILED TO JUSTIFY THEIR PROJECTED  
COMMON LINE BASE FACTOR PORTION REVENUE REQUIREMENT  
AND HENCE THEIR EUCL RATES AND COMMON LINE RATE CAPS.

Part 69 of the Commission's Rules sets forth specific procedures for the development of end user common line ("EUCL") rates. Section 69.104(c) of the Commission's rules requires LECs to calculate their EUCL rates based on a projected test period common line Base Factor Portion ("BFP") revenue requirement and prospective end-user subscriber line volumes for each LEC study area. The LECs have historically employed various forecasting methods to develop the BFP revenue requirement as well as prospective demand.

The proposed EUCL rates are calculated by dividing the projected BFP revenue requirement by the projected subscriber lines for the prospective tariff period. In accordance with the Access Reform Order,<sup>5</sup> the multiline business EUCL per month is then determined to be the lesser of \$9.00 or the calculated average line cost. The residential and single-line business EUCL is determined in the same manner but has a rate cap of \$3.50 per line. As the Commission explained in the 1997 Suspension Order

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<sup>5</sup> Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, FCC 97-158, released May 16, 1997 ("Access Reform Order").

(para. 5), in the Commission-prescribed formula used by price cap carriers to set carrier common line charges ("CCLCs"),

"an increase in the SLC results in a decrease in the CCLC. If a LEC's projections understate the projected BFP, or overstate the projected EUCL demand, then the per-line SLC will recover a smaller portion of per-line common line revenues and CCL charges on IXCs will be correspondingly higher, leading to distortion in the demand for interexchange services."<sup>6</sup> (emphasis provided)

As shown in its June 23, 1997 petition addressed to the price cap LECs' annual access filings (at 2-5), AT&T's analysis of the price cap LECs' filed data indicated that a number of LECs have seriously underforecasted their projected BFP revenue requirements for the prospective period that was used in the development of their EUCL rates. As a result, AT&T's analyses showed that these LECs have understated their proposed EUCL revenues by \$209 million, and, consequently, have also overstated the proposed CCL Rate Caps by \$209 million. Based on data submitted in the LECs' Direct Cases, the current CCL rates are overstated by \$400 million.<sup>7</sup>

In the 1997 Suspension Order (paras. 21-22), the Commission concluded that investigation of the price cap LECs' BFP revenue requirements and EUCL demand forecasts is

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<sup>6</sup> See also Designation Order, para. 5.

<sup>7</sup> See Appendix B, page 4 of 6 and Appendix E, page 1 of 9.

warranted because some carriers based their BFP trend line on only 18-month extrapolations (despite the fact that the Commission had previously indicated that it is difficult to predict an accurate BFP trend line based on just two years of data) and other LECs did not offer adequate support for their BFP revenue requirements, which represented a wide disparity from AT&T's and MCI's analyses. As the Commission correctly observed in the Designation Order (para. 15, citations omitted),

"[a]fter conducting a preliminary analysis of the price cap LECs' current projections, we find that these projections are likely, in many cases, to be inconsistent with the recent trend of actual BFP revenue requirements. Many of the price cap LECs have neither explained fully how they derived their BFP revenue requirement and end-user demand projections, nor have they shown their projections to be consistent with historical patterns."

Although for the 1997 annual tariff filing, the LECs were required to file supporting materials to substantiate their BFP/EUCL calculations, as AT&T showed in its petition (at 3-4), none of the LECs had done so.<sup>8</sup>

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<sup>8</sup> The Commission had expressly required that:

"[b]ecause the [subscriber line charge ("SLC") or EUCL] level in part determines the maximum carrier-common-line rate under prices caps, we would expect information on the SLC calculation to be included in the annual access tariff filing. We believe that the information filed should explain any forecast that deviates from the historical cost or demand trend, and significant differences between actual results and predictions produced by forecast models used in recent annual filings. (emphasis provided).

Accordingly, in order to enable Commission staff to complete an analysis of the LECs' 1997-1998 tariff year BFP revenue requirement estimates and EUCL demand, the Designation Order directed the price cap companies to submit detailed information concerning each.

In particular, as to BFP revenue requirements, each price cap LEC must file: (1) its actual revenue requirements computed using ARMIS data for each calendar and tariff year between the 1991-1992 and the 1996-1997 tariff years, and projected BFP revenue requirements filed in each year's tariff review plan ("TRP") for the same period; (2) a list of any change in its BFP revenue requirements caused by any revisions to the Commission's rules over this period (e.g., allocation of interstate costs associated with general support facilities ("GSF"), separations changes related to the subscriber plant factor ("SPF") and dial equipment minutes of use ("DEM"), USOA changes related to Other Postretirement Employee Benefits ("OPEBs"), and revisions to the allocation of OB&C expenses); and (3) documentation that explains in detail the methodology that

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Material to be Filed in Support of 1997 Annual Access Tariffs, Tariff Review Plans, DA 97-593, released March 21, 1997, para. 8 ("1997 TRP Order"); 1997 Tariff Review Plan Revisions, DA 97-1081, released May 22, 1997 ("May 22 TRP Order"); 1997 Tariff Review Plan Further Revisions, DA 97-1202, released June 5, 1997 ("June 5 TRP Order").

each LEC used to compute its BFP revenue requirement projection for tariff year 1997-1998. Designation Order, paras. 16, 21-22. The Commission indicated that it intended to use calendar year BFP revenue requirements to develop historical trends, and to use actual and projected BFP revenue requirements calculated for tariff years to determine the accuracy of the LECs' past projections (para. 18).<sup>9</sup> The Commission required all price cap LECs to explain and document fully the data, assumptions and methodology to derive BFP revenue requirement projections contained in their July 1, 1997 access tariffs, including an explanation of all calculations and equations used, including the impact of the Commission's recent OB&C Order and Payphone Reconsideration Order, and explain any changes in methodology from 1991 to 1997 (paras. 26-27).

Carriers that based their 1997 BFP revenue requirement on a "bottoms-up" approach or model, rather than historical trends, are required to fully explain their methodology, the factors underlying the projection, and the weight given to each, provide worksheets displaying any statistical analyses and an explanation of why they believe

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<sup>9</sup> LECs were also required to provide detailed explanation of any relatively large year-to-year changes in BFP revenue requirements, to identify whether these changes are outliers or continuing in nature and to furnish an explanation for the deviation (para. 24).

that this approach produces results that are as accurate as projections based on historical trends (para. 29).<sup>10</sup>

With respect to end-user demand, the Commission required all of the price cap companies to provide the past actual average number of total billable access lines, multiline business lines, residential and single-line business lines for the past six tariff years (commencing with 1991-1992) using ARMIS data and to explain any significant difference (i.e., one that is more than 10 percent) between a projection and actual number of lines (paras. 31-32). It also required each LEC either to:

(1) demonstrate that its 1997-1998 tariff year projection is consistent with the historical trends of end user demand,<sup>11</sup>

or (2) state specifically the underlying factors that are expected to change and to express its projected effect in numerical terms.

Finally, the Commission required the price cap LECs to file their actual and projected BFP revenue requirements on a per-line basis for each tariff year

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<sup>10</sup> Moreover, if a LEC changed projection methodologies, it must provide the same information for the 1995-1996 and 1996-1997 tariff years as for their most recent BFP revenue projections so that the Commission staff can make comparisons with at least two prior years (para. 30).

<sup>11</sup> These trends must be estimated for total billable lines, residential lines, multiline business lines and single-line business lines using calendar year data from 1991-1996 (para. 33).

between 1991 and 1996, calculated by dividing the actual BFP revenue requirement by total billable lines. The LECs must then explain any differences between their actual and projected per-line BFP revenue requirements, again measured against the 10 percent significant difference standard, in their annual access filing for each year (paras. 17, 34).

In its petition, in the absence of any supporting data provided by the LECs, AT&T analyzed the price cap LECs' actual historical BFP revenue requirements and EUCL volumes as reported in their ARMIS reports to verify the reasonableness of their prospective BFP revenue requirements and EUCL rates. AT&T performed a year-over-year trend analysis of BFP revenue requirements, using actual BFP revenue requirements as provided in the price cap LECs' ARMIS 43-01 reports for 1991-1996. Data in ARMIS is reported by calendar year. AT&T used these data to determine the actual tariff period BFP revenue requirements and then calculated year-over-year changes. This provided a highly accurate, multiyear trend to forecast BFP revenue requirements. AT&T used this trended growth rate to develop BFP projections for the 1997-1998 tariff period, and also prospective EUCL rates.

AT&T found that in their 1997 annual filings most price cap LECs significantly understated their BFP revenue requirements -- in aggregate by \$209 million -- and thus

underestimated their EUCL rates.<sup>12</sup> With limited exceptions, the LECs have not explained, as they were required to do by the Designation Order (and previously by the 1997 TRP Order), why their projections of BFP revenue requirements for the prospective 1997-1998 tariff period significantly deviate from the historical cost trends.<sup>13</sup>

Indeed, if anything, the information presented in the LECs' Direct Cases validates AT&T's analysis and confirms that, as a group, the price cap LECs have consistently underestimated their BFP and consequently imposed improperly inflated CCL charges on IXCs. Moreover, the data show that regardless of whether a company used a "bottoms-up" approach or a two-year historical trend to

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<sup>12</sup> See AT&T Petition, Appendix B, p. 4. Moreover, and again contrary to the requirements of the 1997 TRP Order, the LECs provided no explanation of their consistent underforecasting of BFP revenue requirements in their recent filings. AT&T's analysis showed that for all Bell Operating Companies ("BOCs") there are significant differences between actual results and predictions of BFP revenue requirements produced by their forecast models used in recent filings. AT&T Petition at 5 n.5. As a group, the BOCs alone have understated their BFP revenue requirements by as much as \$2.3 billion over the last five years. See id. Appendix B, p. 1. Based on the BOCs' own data as reported in their Direct Cases, as corrected, AT&T has confirmed that the BOCs have underforecasted BFP revenue requirements by \$2.1 billion over the past six tariff years. See Appendix B, page 1 of 6.

<sup>13</sup> For the BOCs, BFP revenue requirements have grown, on average, by 4.48 percent annually over the last five years. See Appendix B, page 4 of 6. However, their projected BFP for the 1997-1998 tariff year is virtually unchanged from the prior year.

forecast BFP, the projection techniques were so deficient that none of the LECs has been able to produce relatively accurate results. To the contrary, the price cap LECs have consistently produced inaccurate BFP projections outside of the 10 percent margin-of-error range allowed by the Commission.<sup>14</sup> The justifications that they now advance do not explain the magnitude of the forecasting errors that they have repeatedly made.<sup>15</sup> For the current 1997-1998 tariff year all of price cap LECs that are parties to this investigation, other than Ameritech and Nevada Bell, have significantly underforecasted their BFP revenue requirements. SWBT (at 8-9) candidly admits as much and offers to raise its BFP revenue requirement by \$83 million, a move in the right direction but one that is insufficient to correct the scope of its past forecasting errors.

Several companies contend in their Direct Cases that although their BFP forecast methodology was reasonable, it cannot be a substitute for actual results and advocate use of actual base period BFP revenue requirements rather than projections.<sup>16</sup> Any such shift in methodology would require a rule change and is, in all events, irrelevant to the issue in this investigation of whether the current

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<sup>14</sup> See Appendix C.

<sup>15</sup> See Appendix D.

<sup>16</sup> See Bell Atlantic at 5; GTE at 1.

method, which relies on forecasted data, produced reasonably accurate results.<sup>17</sup>

As shown above, the BFP projections of all the price-cap LECs are of dubious validity, conflict with historical trends and cannot be reasonably relied upon to establish just and reasonable CCL rates. Accordingly, the Commission should require these LECs to use BFP revenue requirement projections that are based on the historical trend of actual costs and use this revised forecasted BFP revenue requirement to develop both their EUCL rates and CCL Rate Caps.

Due to the "small number of observations for each LEC," the Commission found that simple trend analysis would be ineffective when the data used for such an analysis reflects one-time events. Therefore the Commission sought comments on "alternative methods to forecast BFP revenue requirements." Designation Order, para. 25. As shown above, none of the forecasting methodologies that LECs have

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<sup>17</sup> Moreover, the Commission recently rejected proposals that it change the CCL charge calculation methodology, stating "[w]e see no need to make other substantial revisions to the CCL charge calculation method, such as switching from [forecasted to] historical . . . data, when [under the Access Reform Order] these charges will be phased out within a relatively short time." Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, FCC 97-159, para. 172, released May 21, 1997.

applied in the past have produced accurate BFP projections.<sup>18</sup> As acknowledged by the LECs, forecasting errors are caused by the unavailability of necessary data at the time the forecasts are prepared, the LECs' inability to project impacts of one-time events, such as expenses and taxes, and separations rule changes.<sup>19</sup> The LECs will continue to face the same problems in projecting future BFP revenue requirement and EUCL volumes, regardless of which current forecasting technique they employ. The Commission should implement a simple, straightforward, and verifiable forecasting technique that includes a built-in error correction methodology to remove the impact of past forecasting errors. To this end, AT&T supports the Commission's proposal to examine each LEC individually and use the average percentage change to forecast its BFP revenue requirement.<sup>20</sup>

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<sup>18</sup>     See Appendix C.

<sup>19</sup>     See Appendix D.

<sup>20</sup>     See Designation Order, para. 25. SBC also supports (at 21) "the use of individual LEC data for setting percentages to apply for BFP forecasts. These individual data will more closely reflect a LEC's actual costs instead of average LEC costs. . . . Use of a historical trend is just as reasonable an approach for forecasting BFP as any other. Historical trending would simplify the SBC Companies forecasting process for BFP and is consistent with the Commission's goals to streamline the regulatory process."

The other alternatives proposed by the Commission - to include all LECs' BFP revenue requirements by pooling

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LECs should calculate their BFP and EUCL line forecasts by constructing a trend-line based on their adjusted actual historical calendar-year data. For example, the 1997-1998 tariff year projections should be based on the actual adjusted historical calendar year BFP revenue requirements and EUCL volumes for 1991 to 1996.<sup>21</sup>

For each projection period, LECs should also be required to adjust their projections to account for the difference between the actual and forecasted BFP revenue requirement and EUCL lines for the previous period. Including this "error-correction" in the forecasting methodology will ensure that past under/over forecasting

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them into a single data set or to examine each LEC individually and use the median percentage -- are flawed. Because the industry trend varies substantially from the individual company results, the industry trend is an inappropriate method to forecast BFP revenue requirements. Due to the insufficient number of data points, the Commission's other alternative, the use of the median percentage, is similarly inappropriate.

<sup>21</sup> AT&T has employed this technique to forecast the LECs' 1997-1998 BFP revenue requirement. See Appendix B, page 4 of 6. As shown in Appendix B, page 5 of 6, the LECs have underforecasted their 1997/1998 BFP revenue requirement by \$438 million. Consequently, the multiline business EUCL rates are understated by \$129 million and the CCL charges are overstated by \$129 million. See Appendix B, page 6 of 6. The Commission should require the BOCs to reduce their CCL by \$129 million.

errors will not become permanently embedded in the rates and will be removed as soon as possible.<sup>22</sup>

For the purposes of calculating the EUCL and CCL rates for the 1997-1998 tariff years, the Commission should require the LECs to remove the impact of the LECs' past forecasting errors. After calculating the actual calendar year BFP revenue requirements and EUCL volumes for 1991 to 1996 period and adjusting the BFP revenue requirement for all separations changes, the LECs, in their Direct Cases, have properly calculated the difference between the actual per-line and projected per-line SLC rates. Therefore, the LECs must be required to adjust their current EUCL and CCL rates to remove the impact of past under/over forecasting on a going-forward basis.<sup>23</sup> Based on LECs' data provided in their Direct Cases, the current CCL rates are overstated by \$271 million, due to LECs' projection errors during 1991-1992 to 1995-1996 tariff years.<sup>24</sup>

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<sup>22</sup> Bell Atlantic endorses (at 10) such an error correction technique when forecasting its BFP revenue requirement. Specifically, Bell Atlantic states that "the Company's continued reliance on year-over-year growth produces forecasts that are self correcting over time, ensuring that trends that may underlie actual results are captured in the forecasts."

<sup>23</sup> As Bell Atlantic acknowledges (at 6), if the Commission were to require a retroactive adjustment to the BFP or demand calculation, it should allow an adjustment to both access and end user rates.

<sup>24</sup> See Appendix E, page 1 of 9. Because CCL rates are based on the prior period CCL rates, and are not

To remove the impact of the LECs' past forecasting errors, the Commission should require the LECs to increase their 1997-1998 multiline business EUCL rates by \$271 million and to decrease their CCL rates by the same amount. This reallocation of cost recovery between access and end user charges will not affect the LECs' revenue stream.

**II. MOST OF THE LECs HAVE FAILED TO MAKE THE PROPER EXOGENOUS COST ADJUSTMENT TO REMOVE FULLY THE EQUAL ACCESS AMORTIZATION EXPENSES FROM THEIR PRICE CAP INDICES.**

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In the Access Reform Order (para. 314), the Commission required incumbent LECs subject to price cap regulation to make an exogenous cost adjustment to their PCIs to reflect the completion of the amortization of certain equal access costs that commenced prior to price

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recalculated each year as are EUCL rates, any LEC overstatement of CCL rates are carried forward to each successive tariff period, regardless of whether normal price cap changes are made. For example, NYNEX overstated its CCL rates for 1991-1992 tariff year by \$25.4 million, because of a forecasting error in its BFP revenue requirement. If this error had not been made, NYNEX's CCL rates would have been \$25.4 million lower for each tariff period beginning with the 1991-1992 tariff period. On a cumulative basis, NYNEX overcharged the IXCs \$25.4 million each of the last seven years, or a total of \$177.8 million. Similarly, the RBOCs have overcharged, on a cumulative basis, the IXCs by \$1.3 billion from 1991-1992 tariff period through the 1995-1996 tariff period, because of BFP revenue requirement forecasting errors. Consequently, at the end of the 1995-1996 tariff period, the RBOCs overstated their CCL rates by \$271 million annually.

caps and that was reflected in the baseline rates used to initiate price cap regulation. As the Commission explained, such an adjustment is required to ensure that ratepayers are not forced to continue paying for costs reflected in the initial baseline price cap rates that have now been fully recovered and that would already have been removed from rates under rate-of-return.<sup>25</sup>

Specifically, LECs are required by the Access Reform Order to remove the non-capitalized portion of their equal access costs that were included in their initial PCIs.<sup>26</sup> As AT&T showed in its petition (at 6-13), AT&T's review of the material filed by the LECs indicated that most LECs have failed to properly calculate this mandatory exogenous cost adjustment, and, as a result, their PCIs remain overstated.

**A. Most LECs Made An Improper PCI Change Adjustment To Their Equal Access Amortization Exogenous Costs And Failed To Account For Revenue Growth.**

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As the Commission noted in the Access Reform Order, equal access amortization costs were a part of the LECs' initial baseline revenues and PCIs.<sup>27</sup> Accordingly, as AT&T showed in its petition (at 10-13), after identifying

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<sup>25</sup> Access Reform Order, paras. 302-11.

<sup>26</sup> Access Reform Order, para. 311.

<sup>27</sup> Access Reform Order, para. 303.

the "amortization" portion of the equal access expense that entered the price cap revenue stream, a LEC must adjust its baseline equal access amortization costs for revenue growth that has occurred since January 1, 1991. Specifically, the LEC must apply an "R" value true-up to identify the true value of the exogenous cost adjustment at the time (7/1/97) the exogenous adjustment is to be made. Without such "true-up," the equal access amortization costs would not be fully removed from the LECs' PCIs.

In this instance, although the LECs (except Ameritech) properly calculated the amount of non-capitalized equal access costs that entered price caps, they failed to apply the "R" value true-up, and, in fact, inappropriately reduced these amounts by the PCI change since January 1, 1991. As a result, all of the price cap LECs, except one, have substantially understated the exogenous adjustment required to remove equal access costs from their PCIs.<sup>28</sup>

The Designation Order (para. 42) seeks comment on the "R" value adjustment used by Aliant and proposed by AT&T, particularly their use of growth rates in LECs' local switching revenues to calculate the exogenous adjustment.

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<sup>28</sup> Although the Commission made it a party to this investigation, in AT&T's view, Aliant correctly computed the required exogenous cost adjustment. See Aliant Communications Co. "Revised Price Cap Revisions," filed June 9, 1997, WP EXG-EQ-ACC-REV, p. 1 of 1.

It also invited the LECs to submit alternative proposals for measuring the downward exogenous cost true-up adjustment that they are required to make to account for the completion of amortization of equal access non-capitalized expenses, and whether the Commission should prescribe a particular method or allow the use of any reasonable method. The Commission also directed each of the price cap LEC parties (other than Sprint) to submit data on the local switching revenue of their traffic sensitive basket as reflected in their initial price cap filings so as to allow the Commission to calculate the revenue change for each of these LECs from the date they made their initial price cap filings through June 30, 1997.

In their Direct Cases, the LECs challenge the need for, and legality of, an "R" value true-up, but their contentions are meritless. For example, Ameritech (at 4) contends that PCI deflation via the X-Factor adjustment means that a substantial portion of equal access costs have been eliminated from the LECs' PCIs through normal operation of the price cap formula. And, BellSouth (at 11) contends that equal access was a fixed cost that did not grow from year to year. Ameritech's statement is true but irrelevant; it does not obviate the need for the true-up. Whatever equal access revenues have been reduced by the operation of the X-Factor have increased due to growth in demand volumes. As to BellSouth's contention, whether or not equal access